

INDEPENDENT ENERGY PRODUCERS

June 7, 2010

Ms. Mary D. Nichols, Chair
California Air Resources Board
1001 I Street
Sacramento, CA 95812

Dear Ms. Nichols:

The Independent Energy Producers Association (“IEP”) is a trade association representing the interests of independent power producers (IPPs) which are non-utility owned electric generators. Collectively, IPPs own and operate approximately 24,000 MWs of installed electrical generation capacity in California, representing approximately 30% of the total installed electrical generation capacity serving California consumers.

By letter dated March 26, 2010, several of the states’ utilities (“Joint Utilities”) expressed support for the GHG emission reduction goals of AB 32 as well as general direction of CARB’s Scoping Plan to achieve GHG emissions reductions through a broad range of emission reduction measures. IEP shares this position. In addition, we share the concern expressed by the Joint Utilities that some of the Scoping Plan measures will be costly and will impose a disproportionate GHG emission reduction obligation on the electric sector that is well above the sector’s contribution to the state’s overall GHG emissions.

However, we are concerned that the Joint Utilities’ proposed remedy will position the CARB to foster discriminatory impacts within the electric sector based on ownership-type (rather than technology preference). Specifically, the Joint Utilities recommend that the CARB allocate *allowances* rather than *allowance value* to the LDCs to provide regulatory certainty and mitigate impacts on electric ratepayers.

If the Joint Utilities approach is adopted, a tremendous wealth transfer will occur from the independent power producers/merchant power industry to the utilities. For IPPs, this is particularly problematic as the utilities, in addition to their role(s) as a local distribution company, retain an interest in developing utility-owned generation (“UOG”) in direct competition to the independent power producers/merchant power industry.

The allowance value derived from an annual auction may well total in the billions of dollars. The Joint Utilities estimate \$2 billion annually, assuming an allowance cost of \$20/tonne. A significant portion of this allowance value will be derived from IPPs seeking allowance credits necessary to operate their facilities. The conflict arises if either (a) IPPs are required to obtain necessary allowances (i.e. their operating permits) from their competitors the utilities, or (b) the allowance value derived from IPP GHG allowance purchases flows back to their competitors to be used for investing in utility-owned generation (“UOG”).

As IEP shares the CARB’s concerns about mitigating the cost impacts on electric retail consumers, we offer the following recommendation as a viable means to move forward with a fair, open and transparent auction to allocate not only allowances but allowance value in a non-discriminatory manner. Specifically, we recommend the following approach:

Option 1: IEP recommends that 100% of the allowance value be rebated *directly* back to consumers/ratepayers in the form of *direct* rate relief. This is easy to accomplish. Simply put, auction

revenues need to flow directly back to consumers on a dollar-for-dollar basis in the form of rebates and/or bill reductions.

Option 2: If the recommendation to rebate 100% of auction revenues directly back to the consumers through rate relief is not adopted, then, as *a condition precedent to allocating allowances and/or allowance value directly to the utilities*, the following approach should be employed to ensure that the revenues are not used by the utilities to tilt the competitive field nor discriminate against merchant/IPP electric generators:

1. **The CARB should develop regulations prohibiting allowances and/or allowance value (e.g. auction revenues) from being used directly or indirectly to support the utility-owned generation development.** The Joint Utilities' proposal represents a significant transfer of wealth (i.e. "windfall") from the merchant/IPP sector to the utilities/Retail Suppliers, many of whom have an interest in developing, owning, or operating generation facilities in direct competition with the IPPs.¹ If adopted, this approach would foster the types of discriminatory outcomes that the CARB staff seeks to avoid.² To prevent this outcome, CARB's regulations should prohibit allowances and/or allowance value (e.g. auction revenues) from being used by the utilities to support discriminatory outcomes, specifically UOG development interests.
2. **Necessary Protocols in any CARB Regulation addressing allowance allocation and use of allowance value (e.g. auction revenues) to prevent discriminatory outcomes.** To protect against the potential for discriminatory outcomes, IEP proposes that CARB's regulations commit Retail Suppliers to the following:
 - i. **Requirement that Retail Suppliers transfer all freely allocated allowances to an independent Third Party Administrator for purposes of auctioning.** Retail Suppliers must turn over immediately any and all freely administered allowances that they receive to an independent Third Party Administrator.
 - ii. **Requirement that all GHG allowances needed by utilities to achieve CARB GHG compliance for their utility-owned generation be obtained via same mechanisms as available for IPPs.** The means for making allowances available for UOG should be the same as that employed for merchants/IPP. If the mechanism for acquiring allowances by IPPs is to be an auction, then the utilities should be required to acquire any allowances they need for their UOG interests via same mechanism.
 - iii. **Requirement to use independent, Third Party Administrator for allowance allocation/auctioning.** An independent, Third Party Administrator, in coordination with and at the direction of the CARB, shall be responsible for auctioning allowances to all obligated entities, including IPPs and UOG. Retail Suppliers should be required to obtain the allowances that they need to meet their CARB-based GHG compliance obligations through the auction conducted by a Third Party Administrator.
 - iv. **Requirement that auction revenues received by Retail Suppliers shall not be applied toward the development of UOG projects.** It would be inappropriate and discriminatory to allow Retail Suppliers to apply auction revenues, the bulk of which

¹ The scope and scale of this wealth transfer potentially increases significantly the extent to which the CARB sets a "price floor" in any auctioning of allowances.

² Staff Concept: "No discrimination between utility owned and merchant owned power generation." Presented at Public Workshop, "Greenhouse Gas Cap-and-Trade Regulation Status Update," May 17, 2010.

will derive from IPPs, toward the development of their own generation interests (i.e. UOG). To the extent that the auction revenues are applied to the development of eligible renewable resources, Retail Suppliers must apply the auction revenues received not otherwise applied directly to rate reduction (see Option 1 above) to support contracting with eligible renewable resources selected through an open, transparent competitive process, including RFOs and/or bilateral negotiated processes.

3. **Need for Memorandum of Understanding (MOU) between CARB, CPUC and Publicly Owned Utility (POU) Governing Boards.** Recognizing that the CPUC has jurisdictional authority over the IOUs in such matters as rate design, cost recovery, etc., it is imperative that the CARB work directly with the CPUC to establish, in a formal binding MOU, the appropriate rules for utilizing auction revenues that precludes the IOUs from obtaining any competitive advantage from the auction revenues derived from merchant/IPP purchases of allowances. POU Governing Boards should be incented to enter into similar MOUs.

IEP has been a supportive party to AB32. We recognize that the pricing of carbon can drive investment toward preferred technologies. However, the CARB should not impose an allowance allocation mechanism that has discriminatory outcomes skewing the competitive playing field between IPPs and utilities. Any approach that allocates allowances and/or allowance value directly to the utilities will have this effect, unless this approach is conditioned as outlined above. We look forward to working with CARB to ensure that AB 32 implementation does not have these harmful effects nor create a barrier to the investment by the private sector of potentially billions of dollars in new, clean electric infrastructure.

Very truly yours,



Jan Smutny-Jones
Executive Director
Independent Energy Producers Association ("IEP")

cc:

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